

1-6-2006

# Federal Court Strikes Down Nebraska Corporate Farming Law

Roger A. McEowen  
*Iowa State University*

Neil E. Harl  
*Iowa State University*

Follow this and additional works at: <http://lib.dr.iastate.edu/aglawdigest>



Part of the [Agricultural and Resource Economics Commons](#), [Agricultural Economics Commons](#), [Agriculture Law Commons](#), and the [Public Economics Commons](#)

---

## Recommended Citation

McEowen, Roger A. and Harl, Neil E. (2006) "Federal Court Strikes Down Nebraska Corporate Farming Law," *Agricultural Law Digest*: Vol. 17 : No. 1 , Article 1.  
Available at: <http://lib.dr.iastate.edu/aglawdigest/vol17/iss1/1>

This Article is brought to you for free and open access by the Journals at Iowa State University Digital Repository. It has been accepted for inclusion in Agricultural Law Digest by an authorized editor of Iowa State University Digital Repository. For more information, please contact [digirep@iastate.edu](mailto:digirep@iastate.edu).



**Agricultural Law Press**

Publisher/Editor

Robert P. Achenbach, Jr.

Contributing Editor

Dr. Neil E. Harl, Esq.

\* \* \* \*

**Issue Contents**

**Bankruptcy**

General

Exemptions

Homestead **4**

Refund **4**

Federal tax

Administrative expenses **4**

Discharge **4**

**Federal Agricultural Programs**

Fruits and vegetables **4**

Karnal bunt **4**

Milk **4**

Mushrooms **5**

Payment limitations **5**

Potatoes **5**

**Federal Estate and Gift Taxation**

IRA **5**

Valuation **5**

**Federal Income Taxation**

Accounting method **5**

Business expenses **6**

Charitable deduction **6**

Corporations

Estimated taxes **6**

Cost of goods sold **6**

Court awards and settlements **6**

IRA **7**

Levy **7**

Partnerships

Distributive share **7**

Penalties **7**

Pension plans **7**

Returns **7**

Safe harbor interest rates

January 2006 **8**

S corporations

Personal expenses **8**

User fees **8**

Wages **8**

**Water**

Ground water **8**

# Agricultural Law Digest

Volume 17, No. 1

January 6, 2006

ISSN 1051-2780

## Federal Court Strikes Down Nebraska Corporate Farming Law

-by Roger A. McEowen\* and Neil E. Harl\*\*

In late 2005, the Federal District Court for the District of Nebraska held, in *Jones, et al. v. Gale, et al.*,<sup>1</sup> that the Nebraska Constitutional provision restricting unauthorized corporate involvement in certain types of agricultural activities<sup>2</sup> is unconstitutional on “dormant commerce clause” grounds and on the basis that the provision violates the Americans with Disabilities Act (ADA).<sup>3</sup> The Nebraska Attorney General is appealing the ruling to the United States Court of Appeals for the Eighth Circuit, which has ruled twice on anti-corporate farming restrictions in other states in recent years.<sup>4</sup> The case represents the most recent judicial pronouncement concerning the ability of a particular state’s citizenry to shape the future structure of agriculture within that state.

**Overview – Anti-Corporate Farming Restrictions.** Presently, nine states prohibit corporations from engaging in agriculture to various degrees.<sup>5</sup> The restrictions grew out of rising concern across the country that several key sectors of the U.S. economy were becoming controlled by a few large firms and multi-state corporations.<sup>6</sup> While the laws are not designed to slow down or prevent structural change in agriculture, they are designed to control the organizational form of farming operations based on ownership arrangements. Until recently, no appellate-level court at either the state or federal levels had ever held a state anti-corporate farming law unconstitutional.<sup>7</sup>

**Initiative 300.** The Nebraska anti-corporate farming law (I-300) was added to the state Constitution in 1982 by voters through the initiative and referendum process. The law prohibits a corporation or syndicate from acquiring or obtaining an interest in any title to real estate used for farming or ranching in Nebraska, or from engaging in farming or ranching in the state. A syndicate is defined as a limited partnership other than a limited partnership in which the partners are members of a family or a trust created for the benefit of a member of the family, related to one another within the fourth degree of kindred (first cousins) or their spouses, at least one of whom is a person residing on or actively engaged in the day-to-day labor and management of the farm or ranch. Numerous exceptions exist, but the major one is for family farm or ranch corporations (defined as a majority of the voting stock held by members of the family) or a trust created for the benefit of a member of the family. The majority shareholders must be related to each other within the fourth degree of kindred (or be the spouse of a family member), and at least one family member must either reside on the farm or be actively engaged in the day-to-day labor and management of the farm.<sup>8</sup>

*Jones, et al. v. Gale, et al.*<sup>9</sup> The plaintiffs were engaged in agricultural activities to a certain

\*Associate Professor of Agricultural Law, Iowa State University, Ames, Iowa; member of KS and NE Bars and honorary member of Iowa Bar.

\*\*Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

degree. They all claimed that I-300 barred their proposed activities and challenged the law on the basis that it violated the “dormant commerce clause,” the Privileges and Immunities Clause and the Equal Protection Clause of the U.S. Constitution. Two of the plaintiffs were disabled and claimed that I-300 also violated the ADA<sup>10</sup> because of the requirement that at least one family member be “a person residing on or actively engaged in the day to day labor and management of the farm or ranch.”

**The “Dormant Commerce Clause.”** The Commerce Clause of the U.S. Constitution<sup>11</sup> forbids discrimination against commerce, which repeatedly has been held to mean that state and localities may not discriminate against the transactions of out-of-state actors in interstate markets even when the Congress has not legislated on the subject.<sup>12</sup> The overriding rationale of the commerce clause was to create and foster the development of a common market among the states and to eradicate internal trade barriers. Thus, a state may not enact rules or regulations requiring out-of-state commerce to be conducted according to the enacting state’s terms.<sup>13</sup> So, states have the power to regulate economic activity within their borders, but cannot do so in a discriminatory manner. If the state has been motivated by a discriminatory purpose, the state bears the burden to show that it is pursuing a legitimate purpose that cannot be achieved with a nondiscriminatory alternative.<sup>14</sup> However, if the state regulates without a discriminatory purpose but with a legitimate purpose, the provision will be upheld unless the burden on interstate commerce is clearly excessive in relation to the benefits that the state derives from the regulation.<sup>15</sup> In essence, a state is free to regulate economic transactions occurring within its borders in the manner it deems appropriate as long as it is done in a nondiscriminatory fashion, but is not free to regulate economic conduct occurring elsewhere.<sup>16</sup>

**The court’s “dormant commerce clause” analysis.** The court held that I-300 was facially discriminatory because it “was conceived and born in protectionist fervor,” and that the ballot title and language of I-300 clearly indicated that Nebraskans would be given “favored treatment” on the basis that it would be more economically feasible for those living in close proximity to Nebraska farm and ranches to provide “day-to-day physical labor and management.” As such, the court continued down the path established by the Eighth Circuit in two earlier cases involving anti-corporate farming laws from South Dakota and Iowa, where the court did not examine the actual impact on economic conduct by in-state and out-of-state firms, instead relying on statements of legislators and ballot titles to find discrimination against interstate commerce.<sup>17</sup> But, the court appeared to go even further when it stated, “When it is apparent from the *language* of a ...state constitutional amendment...that its *effect* is to burden out-of state economic interests and benefit in-state economic interests, the party challenging it should not be required to bear the burden of an evidentiary hearing to prove the obvious” [emphasis added]. Unfortunately, the court did not provide any explanation as to how the text of I-300, by itself, can have a discriminatory impact on interstate commerce. While the court was correct to examine the text of I-300, the text clearly applies to any corporation or syndicate “organized under the laws of any state of the United States.” The provision does not provide preferential treatment for Nebraska firms

as compared to out-of-state firms. All firms wishing to engage in agricultural activities in Nebraska are subject to an identical set of rules, as far as I-300 is concerned. Consequently, an appropriate question is whether I-300 burdens interstate commerce excessively in relation to the benefits that the state derives from I-300.<sup>18</sup> That is not likely to be the case, particularly since I-300 does not contain any prohibition against agricultural contracting activities.<sup>19</sup>

The court also found a discriminatory effect associated with the requirement that a family member provide (as the court referred to it) “day-to-day physical labor and management.” The actual language of I-300 requires that a family member of a qualified entity be a “person residing on or actively engaged in the day-to-day labor and management of the farm or ranch...” The test is one of *active engagement* and not, as the court put it, the provision of “day-to-day physical labor and management.” While the court relied on *Hall v. Progress Pig, Inc.*,<sup>20</sup> for its reasoning, that case involved the construction of the terms “labor” and “management” and did not directly address the question of the meaning of “active engagement” in the context of the provision of labor and management. There is authority for the notion that “active engagement” requires much less than actually rendering labor and management on the premises. For example, under USDA payment limitation rules, one of the requirements that a farmer (or otherwise eligible entity) must satisfy to be eligible for federal farm program payments is the active engagement test.<sup>21</sup> As part of the active engagement test, the individual (or entity) must make a significant contribution of active personal labor or active personal management (or a combination thereof).<sup>22</sup> While hired services do not count,<sup>23</sup> it is clear that active personal management need not be performed on the farm to satisfy the test – a person can contribute active personal management while living in a distant town.<sup>24</sup> Active engagement in labor activities can be achieved via contract. In any event, under I-300, the mere fact that the shareholder resides on the farm negates the requirement that the shareholder be actively engaged in the day to day labor and management of the farm.

**The ADA Claim.** The Court also found that I-300 was invalid under the Constitution’s Supremacy Clause because it conflicted with the ADA on the basis that two of the plaintiffs were disabled and could not perform the daily physical labor that the court believed I-300 required. The ADA provides that “no qualified individual with a disability shall, by reason of such disability, be excluded from participation in or be denied the benefits of the services, programs, or activities of a public entity, or be discriminated by any such entity.”<sup>25</sup> While the court noted that “public entity” has been construed broadly to apply to all actions of state and local governments, the court did not address the point that I-300 did not involve the action of a governmental body. Instead, I-300 was the result of the initiative and referendum process and was approved by Nebraska voters.<sup>26</sup> No action or activity of government was involved. The court also did not address the applicability of the ADA to Nebraska farming operations. The ADA only applies to “employers” that have 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year.<sup>27</sup>

**Conclusion.** The court’s opinion appears to be seriously flawed in several respects. However, it is questionable whether the opinion will be reversed on appeal. Except for its opinion in *Hampton*,<sup>28</sup> the

Eighth Circuit has not shown much willingness to analyze deeply the dormant commerce clause issue. If the decision stands, it will have a dampening effect on a state's efforts to ensure competitive markets for agricultural products and a level playing field for independent agricultural producers. Increased pressure could also be placed on the Congress to address the anti-competitive effects of concentrated agricultural markets and vertically integrated agricultural production supply chains.

#### Footnotes

<sup>1</sup> No. 8:04-CV645, 2005 U.S. Dist. LEXIS 35361 (D. Neb. Dec. 15, 2005).

<sup>2</sup> The Nebraska provision is contained in Article XII, Section 8 of the Nebraska Constitution.

<sup>3</sup> The court did rule, however, that the Nebraska provision did not violate the Privileges and Immunities Clause or the Equal Protection Clause of the U.S. Constitution.

<sup>4</sup> See *South Dakota Farm Bureau, Inc. et al. v. Hazeltine*, 340 F.3d 583 (8th Cir. 2003), *cert. denied*, 541 U.S. 1037 (2004); *Smithfield Foods, Inc. v. Miller*, 367 F.3d 1061 (8th Cir. 2004), *vac'g. and rem'g.*, 241 F. Supp. 2d 978 (S.D. Iowa 2003).

<sup>5</sup> The states are Iowa (Iowa Code § 9H.1 *et seq.*); Kansas (Kan. Stat. Ann. § 17-5901 *et seq.*); Minnesota (Minn. Stat. Ann. § 500.24 *et seq.*); Missouri (Mo. Ann. Stat. § 350.15); Nebraska (Neb. Const. Art. XII, § 8(1)); North Dakota (N.D. Cent. Code § 10-06.1-02); Oklahoma (Okla. Const. Ar. XXII, 2); South Dakota (S.D. Codified Laws § 47-9A-3); and Wisconsin (Wis. Stat. Ann. § 182.001).

<sup>6</sup> These concerns resulted in passage of the Sherman Act in 1890, the Clayton Act in 1914, the Packers and Stockyards Act in 1921 and the Robinson-Patman Act in 1936. The basic idea of federal intervention in the marketplace was to maintain competition and protect small, independent businesses against unfair competition from vertically integrated, multi-location chain stores.

<sup>7</sup> See, e.g., *Asbury Hospital v. Cass County*, 326 U.S. 207 (1945), *aff'g*, 16 N.W.2d 523 (N.D. 1944) (upholding North Dakota provision against alleged violations of equal protection, due process, privileges and immunities, and contract clauses of Constitution); *State ex rel. Webster v. Lehndorff Geneva, Inc.*, 744 S.W.2d 801 (Mo. 1988) (upholding Missouri provision against equal protection and due process challenge); *Omaha National Bank v. Spire*, 223 Neb. 209, 389 N.W.2d 269 (1986) (upholding Nebraska Constitutional provision against equal protection challenge).

<sup>8</sup> A stockholder can be a corporation or partnership if all of the stockholders or partners are related within the fourth degree of kindred to the majority of stockholders in the family farm corporation.

<sup>9</sup> No. 8:04-CV645, 2005 U.S. Dist. LEXIS 35361 (D. Neb. Dec. 15, 2005).

<sup>10</sup> 42 U.S.C. §§ 12101 *et seq.*

<sup>11</sup> Article I, § 8, Clause 3.

<sup>12</sup> See, e.g., *Dean Milk Co. v. Madison*, 340 U.S. 349 (1951) (holding as unconstitutional city ordinance prohibiting sale of milk in city unless bottled at approved plant within five miles of city); *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977) (state statute requiring all closed containers of apples sold or shipped into state to bear "no grade other than applicable U.S. grade or standard" held unconstitutional discrimination against commerce).

<sup>13</sup> See, e.g., *American Meat Institute, et al. v. Barnett*, 64 F. Supp. 2d 906 (D. S.D. 1999) (South Dakota price discrimination statute declared unconstitutional because it applied to livestock slaughtered in South Dakota regardless of where livestock purchased).

<sup>14</sup> See, e.g., *Hughes v. Oklahoma*, 441 U.S. 322 (1979). But, the plaintiff bears the initial burden of proving discriminatory purpose. *Id.*

<sup>15</sup> See, e.g., *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970) (state law prohibiting interstate shipment of cantaloupes not packed in compact arrangements in closed containers, even though furthering legitimate

state interest, held unconstitutional due to substantial burden on interstate commerce).

<sup>16</sup> See, e.g., *Baldwin v. G.A.F. Seeling, Inc.*, 294 U.S. 511 (1935) (court struck down statute requiring milk purchased out-of-state to not be sold in New York unless out-of-state producers had received New York minimum price); but see *Nebbia v. New York*, 291 U.S. 502 (1934) (court upheld New York law setting minimum prices paid to milk producers, as applied to purchases by New York retailers from New York producers).

<sup>17</sup> *South Dakota Farm Bureau, Inc. et al. v. Hazeltine*, 340 F.3d 583 (8th Cir. 2003), *cert. denied*, 541 U.S. 1037 (2004); *Smithfield Foods, Inc. v. Miller*, 367 F.3d 1061 (8th Cir. 2004), *vac'g. and rem'g.*, 241 F. Supp. 2d 978 (S.D. Iowa 2003).

<sup>18</sup> In *Hampton Feedlot, et al. v. Nixon*, 249 F.3d 814 (8th Cir. 2001), the court upheld against a dormant commerce clause challenge provisions of the Missouri Livestock Marketing Law which barred livestock packers purchasing livestock in Missouri from discriminating against producers in purchasing livestock except for reasons of quality, transportation costs or special delivery times. The court noted that the Missouri statute only regulated livestock sold in Missouri and was indifferent to livestock sales occurring outside Missouri and had no chilling effect on interstate commerce because packers could easily purchase livestock other than in Missouri to avoid the Missouri provision. In addition, the court specifically opined that the Missouri legislature had the authority to determine the course of its farming economy and that the legislation was a constitutional means of doing so.

<sup>19</sup> The court mistakenly stated that I-300 barred one of the plaintiffs from entering into contracts with out-of state firms for the raising and feeding of livestock. That would only be the case if, under a particular contract's terms, an otherwise disqualified organization either obtains an interest in Nebraska real estate used for farming or is deemed to be engaged in farming in Nebraska. Unfortunately, the court did not provide that necessary analysis.

<sup>20</sup> 259 Neb 407, 610 N.W.2d 420 (2000). The Nebraska Supreme Court held that I-300 required the shareholder to render physical labor and participate directly in management of the operation.

<sup>21</sup> 7 U.S.C. § 1308-1(b).

<sup>22</sup> 7 U.S.C. § 1308-1(b)(2)(A)(i).

<sup>23</sup> 7 C.F.R. § 1400.3.

<sup>24</sup> Also, USDA regulations define "active personal management" to include the marketing and promotion of agricultural commodities produced by the farming operation." 7 C.F.R. § 1400.3. That seems to indicate that "active personal management" can be found to be present through a crop marketing agreement with another farming operation. See *Mages v. Johanns*, No. 03-1400, 2005 U.S. App. LEXIS 28735 (8th Cir. Dec. 27, 2005) (issue mentioned but not in issue; reserved for possibility of being raised on remand).

<sup>25</sup> 42 U.S.C. § 12132. Under the statute, "public entity" is defined to include "any State or local government; [and] any department, agency, special purpose district, or other instrumentality of a State or States or local government." 42 U.S.C. § 12131(1)(A)-(B).

<sup>26</sup> The court simply referenced an earlier opinion of a different federal court on the same issue for the proposition that I-300 violated ADA. See *South Dakota Farm Bureau v. Hazeltine*, 202 F. Supp. 2d 1020 (2002) (ADA claim involving an amendment to the South Dakota anti-corporate farming law).

<sup>27</sup> 42 U.S.C. § 12111(5)(A)

<sup>28</sup> 249 F.3d 814 (8th Cir. 2001).